

### The Spanish Economy : perspectives at the end of 1993;

As a result of the general elections, a new government was formed in Spain in July 1993. During the last months the new government has been engaged in deciding the lines upon which the budget would be made. As mentioned in the previous report published in July, the public deficit is one of the main disequilibria in the Spanish economy and a careful examination of the amount involved and the efficiency obtained in each expenditure item was required. Partly in this direction the new team in the Ministry of Economic Affairs in Spain has designed a restricted budget in which the total amount of expenses for 1994 would be 1.3% less than the expected expenses in 1993. With an increase of 3.9% in the expected revenues the resulting deficit for 1994 would be 5.2% in terms of GDP. This percentage is obtained assuming an increase of GDP of 1.3% at constant prices, which certainly is an optimistic assumption. Even so, the deficit would just drop from 6.2% — expected figure for 1993 — to 5.2% which would still be higher than the percentage deficit registered during each one of the years between 1990-1992.

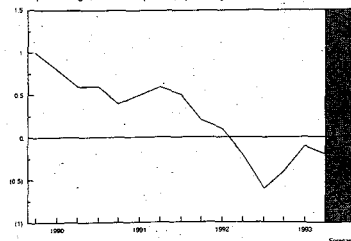
The accomplishment of these measures could reduce the uncertainty existing around the Spanish economy and could create new expectations but, in the very short run, the Spanish economy would be evolving according to the dynamic forces already in operation. Thus during the second quarter of 1993 the decline in industrial production in Spain has continued at rates slightly higher than those forecasted in the previous report. This means that industrial production in Spain was decreasing around 7% at the beginning of 1993 and around 5% at the end of the second quarter with a forecast of a 4.3% decrease in the near future. This deterioration of industrial production with respect to the previous forecasts has taken place both in the consumption and equipment sectors, with forecasted rate of changes of -4.5% and -7.2%, respectively, at the end of 1993. The annual rates used here

#### SPAIN

Nominal GDP (1991, billions pesetas)	54 775
Population (millions, mid 1989)	39.0
Exports (1991, billions pesetas)	9454.4
Imports (1991, billions pesetas)	11 172.5
Dollar Exchange Rate (end September 1993)	131.56

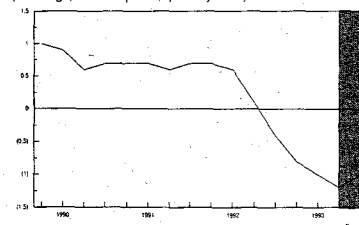
Forecasts are Averages

GDP (% change, constant prices, quarterly rates)



Private Consumption

(% change, constant prices, quarterly rates)

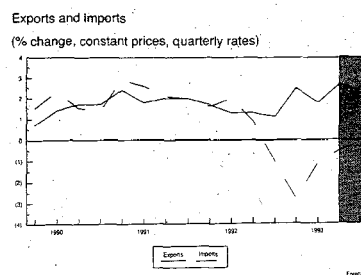
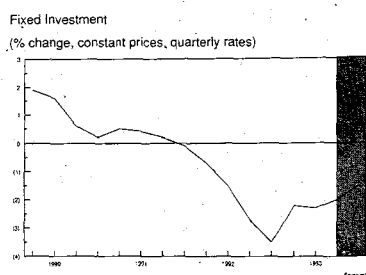


correspond to the trends of the corresponding industrial production indexes. In what follows the rates of variation in trends will be called underlying rates.

Analyzing the production in other sectors of the economy using the employment figures, one could say that the building sector is destroying employment all through 1993 at an underlying annual rate around 7.5% which is worse than previous forecasts, and is expected to continue in the near future. The service sector was reducing employment at a rate of 1.5% early in 1993 and could end the year at a zero rate of growth which implies a slight improvement with respect to the previous forecasts. Overall the reduction in employment in the whole Spanish economy will pass from an underlying rate of 4.5% in the first quarter of 1993 to a rate of 2.9% at the end of the year. This implies that unemployment at the end of 1993 would be at 3.6 million, which would represent 24.5% of the working population.

With respect to the foreign sector, the three devaluations of the peseta which have occurred since September 1992 have depressed the Spanish nominal imports which have passed from an underlying annual rate of growth of 11% in the first part of 1992 to a negative rate in the first months of 1993 and could end up this year with a zero rate of growth. On the other hand, the nominal exports which were experiencing underlying rates of growth of 7% before the first devaluation, were increasing at rates of 16% in June 1993. Given the relative contention of prices this evolution in nominal foreign trade is having real effects and it will have a positive contribution of more than 2.5% in the annual rate of variation of the Spanish GDP in 1993.

In fact, due to the important depression that the Spanish economy is enduring, the 21% devaluation of the peseta since September 1992 has only induced at most an increase of 0.7% in inflation. Thus, the underlying inflation measured through the trend in the consumer price index has been quite stable around 4.8% during 1993, which is about



0.7 points greater than the underlying inflation at the end of 1992. Nevertheless these inflation rates are still too high, but if the government implements a zero rate of growth for salaries in the public sector and if in the private sector salaries don't grow more than 2%, as recommended by the government, then inflation at the end of 1994 could be around 3.5%.

The implications of the previous analysis on the macroeconomic aggregates are shown in Table 1, where the reader can see that consumption is going to continue being highly depressed in 1993 with quarterly rates of variation around -1.0%. At the same time, fixed investment will continue decreasing but with more moderate rates than in previous quarters. As a result of all this, domestic demand in Spain will decrease by 3.6% in 1993 and only the positive contribution of the foreign sector will mean that the decrease in GDP would be kept to 1.1% this year.

Fixed investment is the component of domestic demand which is experiencing higher negative rates of variation and for longer time. This situation has been related with the uncertainty and bad expectations existing during the last two years about the Spanish economy and with high interest rates. Ex-ante real interest rates in Spain have fallen five points through 1993, but they are still too high with values between 4.5 and 5.5%. Reductions in interest rates in Spain depend on the interest rate movements in Europe but also on the domestic conditions. In this respect the public deficit is putting excessive pressure on the financial markets and a recovery of investment would require that the budget measures for 1994, which are not restrictive from the deficit point of view, should be, at least, accomplished, applying more reductions on expenditures if the forecasted revenues are not obtained.

The contribution of the foreign sector to the rate of change of GDP would be reduced in the second half of 1993 because the imports at constant prices could be recovering, even when maintaining negative rates of variation which in absolute values would nevertheless be lower than the corresponding negative rates in domestic demand. In order to keep and increase the positive effects of foreign trade it would be necessary to reduce Spanish inflation and to bring it closer to the values registered in the main European countries. This should be an aim for all the parts involved in the wage negotiation for 1994 and I am inclined to think that this will be the case. But if this is not, the loss of competitiveness should be recovered through a new depreciation of the peseta, which then should be taken with more drastic measures to curb a deteriorated inflationary process.

On the other hand, the government measures introduced in the budget for 1994 show a decision to tackle the economic problems

with lesser political restrictions, implementing prescriptions that although could be considered required, are unpopular, like the reduction in net unemployment benefits. With this orientation it has been planned that the expenditures in infrastructure increase 9.8% in 1994 and the other expenditures decrease 1.75%. These budget modifications, while important, are not enough and more radical ones related to public employment and the status and productivity of the public employees together with the kind, extent and financing of the welfare state, would be necessary to consider in the near future. But it is very important that the budget goals should be achieved in order to show that there is no ambiguity from the part of the government on the management of the economy and to stimulate an improvement of expectations which could induce an increase of foreign investment in Spain.

Under the previous considerations, the worst moment of the present crisis in Spain could have happened in 1993, and negative rates of variation in GDP should not be expected for 1994. A positive growth for this year is also possible but it would require a reduction in inflation of no less than 2% from its present level in order to increase the competitiveness of Spanish products, and also that social changes in the job market and the fulfillment of the budget prescriptions really create new and firm expectations for investment, which could push up domestic demand until private consumption finally recovers. On the other hand a failure in reducing inflation and a deficit for 1994 greater than the 5.2% planned could impel a new devaluation of the peseta and a loss of credibility from foreign investors which could submerge the Spanish economy in a longer recession.

	Observed values					Forecasts		
	1992a		1993a					
	III	IV	I	II	III	IV 1992b	1993b	
Private consumption	0.1	-0.4	-0.8	-1.0	-1.2	-1.0	2.1	-2.4
Public consumption	0.7	0.6	-0.5	1.0	0.0	0.3	3.8	1.1
Fixed investment	-2.7	-3.5	-2.2	-2.3	-2.0	-1.5	-3.9	-9.4
Domestic demand	-0.2	-1.0	-1.6	-0.8	-0.9	-0.7	1.1	-3.6
Exports	1.3	1.1	2.5	1.8	2.7	2.4	6.7	7.8
Imports	0.9	-1.0	-2.8	-1.1	-0.5	-0.1	6.6	-3.6
Gross Domestic Product	-0.2	-0.6	-0.4	-0.1	-0.2	-0.1	0.8	-1.1
a: Quarterly rates								
b: Annual rates								